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ABSTRACT

Changes in the Australian taxation system are discussed in reference to two central issues: (1) achieving horizontal and vertical equity within the tax-transfer system; and (2) interrelating taxation and social security systems. Horizontal equity embodies the principle that those in similar economic circumstances should pay the same levels of taxation. Vertical equity embodies the principle that those whose income is greater (after adjusting for horizontal equity considerations) should pay relatively more tax. Both the taxation and social security systems have been recognized as alternative and complementary means of achieving certain objectives (especially in achieving vertical equity), and the overlap of various provisions in either system recently is recognized as problematic (especially as they create poverty traps and work disincentives). However, little discussion of the need to include the social security system has occurred in the current context of reforming the taxation system. The same may be said regarding the need to support, or at least treat equitably, families raising children, especially those on low incomes. This discussion, then, focuses on two main propositions: families with children require adequate support through the tax-transfer system; and such support should be provided through an integrated tax-transfer system. (RH)

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CHANGING THE AUSTRALIAN TAXATION SYSTEM

Towards a family income guarantee

SUBMISSION TO THE
ECONOMIC PLANNING ADVISORY COUNCIL

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MAY 1985

Erratum

IFS Submission to the Economic Planning Advisory Council

Changing the Australian Taxation System

Page 20, line 6 should read:

the extra cost would be about **$770 million.**

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Introduction

Changes to the Australian taxation system should reflect a thorough examination of two important issues; the first having long been a fundamental of tax-transfer policy and the second more recently identified and discussed.

The Institute of Family Studies (IFS), in accordance with its brief to examine those factors affecting the well-being of all Australian families, submits that proper emphasis must be placed on the needs of families with children, especially those on low incomes. This is the first issue mentioned above; that of the achievement of both horizontal and vertical equity within the tax-transfer system.

The second issue focuses on the interrelationship between the taxation and the social security systems. Both systems have been recognised as alternative and complementary means of achieving certain objectives especially to do with vertical equity, and the overlap of various provisions in either system has been recognised in recent times as problematic, especially in the creation of poverty traps and work disincentives. However, little discussion of the need to include the social security system has occurred in the current context of reforming the taxation system. The same may be said regarding the need to support, or at least treat equitably, families raising children, especially those on low incomes. This submission, then, focuses on two main propositions:

- families with children require adequate support through the tax-transfer system; and

- such support should be provided through an integrated tax-transfer system.

Neglect of Fundamental Issues

Much of the reported concern regarding the current system of taxation in Australia appears to be about two issues; the incidence of tax falling increasingly on PAYE taxpayers and on middle-income earners, and on the alleged disincentives to pay tax inherent in high marginal tax rates. Much of the support for a shift toward broad-based consumption taxes is predicated on these two concerns, the reputed benefits of such a move being to reduce marginal rates on personal tax and to catch tax evaders via their consumption of goods and services.

The Institute of Family Studies, while not denying that these two concerns are important, submits that other matters are of equal import and as yet have received little attention, at least as indicated in publicly available discussion materials. The matters IFS regards as of great concern are those of inadequate support for families with children, inequitable trends in the current tax-transfer system, inappropriate arrangements under current structures and inefficient outcomes, particularly with regard to labour market participation of family members. Whatever the future shape of the taxation system, whether it features more or less indirect taxation, taxes on wealth, broader definitions of income within direct taxation, or changes to the current scales of personal and company tax, IFS views as fundamentally important the achievement of a more equitable system both in terms of treatment of families with children (horizontal equity) and in terms of ability to pay (vertical equity).

Social Security is Part of the Tax-Transfer System

The operation of the social security system must be examined at the same time the taxation system is under scrutiny to assess how families are affected with respect to equity and efficiency considerations. Overall, income redistribution is determined by

the interaction of the two systems. Both systems affect incentives to work or save, especially where they intersect. Particular objectives can be achieved by measures in either system or by complementary approaches in each. For example, concern to provide for horizontal equity, that is, to ensure that families with and those without children bear similar tax burdens, is achieved by the provision of cash payments for children through the social security system (family allowances) and tax expenditures or rebates through the tax system (dependent spouse rebates, sole parent rebates). Concerns regarding vertical equity, or the principle that families should be liable for tax according to their varying abilities to pay, are provided for by income tests for pensions and benefits within the social security system and by progressive rates of tax payable within the taxation system. To underscore the point that redistribution of incomes to achieve more equitable outcomes may be achieved interchangeably through either system, cash payments to families through the income support system are sometimes referred to as 'negative taxes' (Saunders, 1982:13; Warren, 1984:34; Harding and Whiteford, 1985:4). Both systems must be considered simultaneously to ensure that more effective and efficient support is provided to families.

Fair Treatment for Families with Children

The notion of horizontal equity has been part of the lexicon of economists concerned with the design of tax-transfer systems for well over two centuries. It seems that currently those concerned with the Australian system are in danger of forgetting the principle underlying fair treatment of those raising children. To reiterate, horizontal equity embodies the principle that those in similar economic circumstances should pay the same levels of taxation. Not only income but demands made on that income must be considered, the most important of which has been traditionally, the number of dependants supported by that income. Thus two taxpayers with equal incomes, the first having no

dependants and the second having children to support, are not regarded as being in equal circumstances. A lower tax liability or other concessions must be made to compensate families with dependants.

Support for children in families has long been a fundamental tenet of Australian society. In the frenzy of self-interested calls for lower taxes on high income earners or on profits, or for no impost to be made on capital gains or accumulated wealth, the basic needs and rights of Australia's children and those that raise them have been overlooked completely. It is time for this imbalance to be redressed.

If the Australian community sees itself as requiring a future, it needs to invest in its children. Families with children can not, and should not, be expected to stand alone, to shoulder the entire burden of providing for the next generation out of their own resources.

Modern society instead requires a <u>partnership</u> between private and public care, between what families can provide and what can only be provided out of shared community finances and organisations. Just as families can no longer, and are not expected to, provide adequately for the education of their members, their health care, their communication and transport facilities, neither can they alone find jobs, always earn an income, even sort out their own personal problems without community support. It is too easily forgotten by some who complain about the high cost of 'welfare', social security payments, unemployment benefits and so on, that they have themselves happily accepted and benefited from 'welfare' subsidies for their professional training, health care and all the myriad public services so essential to and taken for granted in every modern state. We know that family income and other associated family resources are crucial to the child's education and the quality of learning. It follows then, that <u>all</u> those prepared to have and/or to care for children should be

compensated for that burden and guaranteed an adequate income level so the quality of care they give can be optimal. The cost of raising children should be shared across the whole society, so no family has an unequal burden.

While it is probably impossible to fully compensate families for the cost of raising children, and in these times when nearly all children are a result of conscious choice, it is probably not expected by such families that society do so, it is still important to ensure that at least families are not so disadvantaged by the presence of children that they are discouraged from having them or are placed in real economic jeopardy. It is clear that any proposal to reduce the level of community resources available to families with children, such as means-testing or taxing family allowances or paying them at a flat rate, would amount to an extra tax on those families. Any such proposals should therefore be accompanied by proposals to increase the tax liabilities of all families without children. That such a proposition would probably be regarded with horror by most proponents of cost-cutting attacks on family support programs is further indication of the retreat from a fair deal for families with children at the present time.

Children Should Not Live in Poverty

The Australian tax-transfer system has long given emphasis to the principle of vertical equity, that those whose income is greater (after adjusting for horizontal equity considerations) should pay relatively more tax. The presence of children is recognised as one of the factors limiting the ability of families to increase their disposable income by their own efforts. The requirement to care for children, with inadequate provision of support services such as child care, provides significant barriers to families adding to their private income by a second earner working or by a single parent entering the labour force. Unemployment in recent years has exacerbated the problems faced by all families, but

when added to the high costs faced because of the presence of children, has generated extra problems for families with children.

Various components of the tax-transfer system as it now exists attempt to redistribute income from those with higher incomes, with or without children, to those on low incomes raising families. For example, while family allowances are paid at a flat rate to all families, they represent a greater proportion of the incomes of low income families than of high income families and may therefore be regarded as a progressive 'negative' tax. While IFS recognises that it is probably not necessary or possible on horizontal equity grounds to fully compensate families for the cost of raising children, it is absolutely non-arguable that low income families with children should be given such income support as necessary to provide a reasonable standard of living for them. No child should be raised in poverty in Australia.

As both taxation and social security systems have as a major objective the redistribution of incomes (Ingles, Jackson, Podger and Raymond, 1982:3; Harding and Whiteford, 1985:3), the point is reiterated that greater integration of both systems is desirable to assist low income families. Currently, measures adopted through the social security system are more effective in reducing income inequality than are those incorporated in the taxation system (Saunders, 1982:86; Harding, 1984). If vertical equity considerations are to be regarded as essential to any reform of the Australian taxation system, it may be more effective to incorporate those features of the current income security system which achieve greater redistribution than those in the current tax system which do not.

The Current System of Assistance to Families with Children

Government assistance to families with dependent children is given both through the taxation system and the social security system.

Outlays through the social security system consist of:

- family allowance payable to all families with dependent children;
- additional pension or benefit for children of pensioners and beneficiaries;
- a mother's/guardian's allowance for a single parent pensioner or beneficiary; and
- family income supplement for low income families with children.

Assistance through the taxation system is given in the form of the following tax expenditures:

- dependent spouse rebate for one-earner couples with a dependent spouse and dependent children; and
- sole parent rebate.

The amounts payable through the social security system (November 1984) are as follows:

		$ per week
. Family allowance:	1st child	5.26
	2nd child	7.51
	3rd child	9.00
	4th child	9.00
	Each additional child	10.51

- Additional pension or benefit for children (per child) 14.00

- Mother's/guardian's allowance (per single parent family) 10.00

- Family Income Supplement (per child) 14.00

The aggregate costs of these payments in 1983-84 (Department of Social Security) were:

	$ '000
- Family allowance	1 506 318
- Additional pension or benefit for children	461 000
- Mother's/guardian's allowance	87 500
- Family Income Supplement	36 129

All families are eligible for family allowance payments and in 1983-84 nearly 2.2 million families with over 4.3 million children received assistance (Department of Social Security, 1984). The other payments are made to families in need of extra assistance and are paid in addition to the family allowance and are also non-taxed. They are, however, paid according to a means-test. Additional pensions or benefits for children were paid to some 405 000 families with over 769 000 children in 1983-84. The mother's/guardian's allowance was paid to some 249 000 one-parent families, and Family Income Supplement was paid to 26 500 families with 74 000 children in 1983-84.

Assistance through the taxation system consists of:

- Dependent spouse rebate for a taxpayer with a dependent spouse with or without children; and

. sole parent rebate for a sole parent taxpayer with dependent children.

The amounts payable through the taxation system (November 1984) are as follows:

	$ per year
. Dependent Spouse Rebate for single earner family	
- Without dependent children	830
- With dependent children	1 030
. Sole parent rebate	780

The aggregate cost of these tax expenditures in 1982-83 (Departments of Finance and the Treasury, 1984) were:

	$ '000
. Dependent Spouse Rebate	
- Without dependent children	298 000
- With dependent children	680 000
. Sole Parent Rebate	73 000

Incomes of Families with Children

An examination of changes in the disposable incomes of families from 1976-77 to 1984-85 (Harding and Whiteford, 1985:28, Institute of Family Studies 1985a) shows that the real disposable incomes of families with dependent children, both pensioner and beneficiary families and families with one or both parents in the workforce, has deteriorated compared with people without children on the same income level. The more children in a family, the greater the deterioration of the family's relative real disposable income. The only exception to this trend has been low income working families whose real disposable incomes

have improved significantly due to the introduction of the Family Income Supplement in May 1983. In addition, the real disposable incomes of some pensioner and beneficiary families with children, particularly single parent pensioners with two or more children has fallen in real terms over this period (Table 1). 1976-77 was taken as the basis for comparison since this was the year in which child tax rebates were abolished and the current level of assistance for families with children, family allowances, were introduced.

These trends have occurred because of the decline in the real value of payments to families through the social security system from 1976-77 to 1984-85.

- INSERT TABLE 1 HERE -

The dramatic decrease in the real value of family allowances over this period, as shown in Table 1, has more significance for low income families, particularly larger families, since family allowances represent a greater proportion of their real disposable incomes than middle to higher income families.

In contrast, assistance to families with children through the taxation system was increased during this period (Table 2).

- INSERT TABLE 2 HERE -

From the mid 1970s until the early 1980s, tax policies for families emphasised spouse dependancy rather than the presence of children as the major criterion for the granting of tax relief (Saunders, 1982:59). Perhaps in recognition of the greater need of families with children, a change was instituted in 1982 with the introduction of a new component in the dependent spouse

rebate, that is, an increase in the rebate for married couples with dependent children (Departments of Finance and the Treasury, 1982-83:241). As Table 2 shows, the dependent spouse rebate for couples with children has increased in real terms since 1976-77, whereas the real value of the rebate for married couples without children has deteriorated.

The dependent spouse rebate for families with children provides no assistance to many two-earner married couples with children, since this rebate is means-tested on the income of the second earner. The dependent spouse rebate for married couples with children is reduced by 25 cents for every dollar earned when the second earner's income is over $282 a year and disappears completely when his or her income reaches $4400 a year.

The increase in the sole parent rebate provides little assistance to the majority of single parent pensioners, who do not have sufficient private income or earnings to take advantage of this increase. For instance, in June 1984, 71 per cent of supporting parent beneficiaries had no private income or earnings (Department of Social Security, 1984:123). The taxable part of their pension ($89.40 a week) was substantially less than the income of $7195 a year ($138 a week) at which a single parent was liable for tax.

It has been argued that assistance to families with children has been directed through the tax system rather than through the outlay side of the budget in recent years because of the relative visibility of direct expenditures compared to tax expenditures (Edwards, 1982:109; Ingles and others, 1982:11-17). Since 1976, when major offsets or measures to give tax relief for dependent children were transferred from the tax system to the social security system, there has been pressure to income test or tax family allowances. The revenue costs of family-related tax expenditures, however, were not published in the Budget Papers until 1980-81 (Ingles and others, 1982:12) and it is not until recently that there has been mounting pressure from some sections

of the community to income test or abolish the dependent spouse rebate (Australian Council of Social Services, 1985; Cass, 1985).

Many sections of the community do not understand or accept the relationship of family allowances to the personal income tax system. This is shown by calls to means-test all welfare payments, including family allowances, as in a recently reported proposal by the Australian Associated Stock Exchanges to EPAC (Garren, 1985). As discussed earlier, this amounts to a call for increased taxes on families with children.

The Department of Social Security submission to the Inquiry into Taxation Expenditures argued that family allowances should be presented in the Budget Papers in such a way as to make their relationship with the personal income tax system clearer than at present (Ingles and others, 1982:17).

The Institute of Family Studies stresses that family allowances are a horizontal equity measure to give tax relief to people with children, and as such should be regarded as part of the tax system, or a 'negative' tax payment (Edwards, 1980:1953; Ingles and others, 1982:18-20; Saunders, 1982:62). Family allowances also improve vertical equity as they are of greatest assistance to low income families.

Families in Poverty

The submission to EPAC by the Institute of Family Studies in November 1984 detailed findings from the 1981-82 Income Survey data of significant increases in the number of families with children in poverty (Institute of Family Studies, 1985b). It was noted that although there have been a number of government initiatives since 1981-82 to improve the situation of low income families, when payments are compared with poverty line allocations, these measures still fall far short of horizontal and vertical equity objectives.

Poverty line figures for November 1984 show that all pensioners and beneficiaries with children on the basic rate of pension or benefit are below the poverty line (Table 3). Larger families are further below the poverty line than smaller families.

- INSERT TABLE 3 HERE -

One reason why the basic rates of pensions and benefits are below the poverty line is that the amounts allowed for the cost of a child by the poverty line figures are substantially higher than payments for children of pensioners and beneficiaries. Poverty line figures estimate the cost of a child as $34.20, whereas pensioners and beneficiaries receive $14 a week plus family allowance payments.

The present poverty line scale is a simplified version of the original scale used in the main calculations of poverty for the Commission of Inquiry into Poverty. It neglects increases in the cost of children according to age which were taken into account under the original scale (Henderson, 1982:113-114).

Although the Melbourne University poverty line is generous in the amounts allocated for the cost of children compared with the Social Welfare Policy Secretariat estimate (SWPS, 1981), the Institute of Family Studies' estimates of the cost of children, according to age, shown in Table 4, lend support to the Melbourne University poverty line figures (Lovering, 1984:1).

- INSERT TABLE 4 HERE -

These figures are a <u>basic survival</u> costing for low income families. They do not include costs of housing, transport, school fees or uniforms, child care, holidays or medical and

dental expenses, costs which many parents regard as essential if their children are to participate fully in Australian society.

Recent data from the 1984 Household Expenditure Survey lend support to the argument that pensioner and beneficiary families, in particular, do not have adequate income for their needs since 'households principally reliant on government cash benefits whose head was aged less than 65 years were on average dissaving ... in the case of sole parents, income averaged $170 a week and expenditure $201 a week' (Harding and Whiteford, 1985:27). Unfortunately, the sample size is too small at present to draw any conclusion about 'dissaving' among low income families in general, although 1975-76 Household Expenditure Survey Data indicate it may be a prevailing pattern (ABS, 1978:12-16). The implications are that such families must run down assets, incur substantial levels of indebtedness and/or rely on charity merely to survive.

Families with Children are Worse Off

To summarise, our examination of the adequacy of assistance to families with children since 1976-77 shows the following:

- compared with people without children on the same income level, the real disposable incomes of all families with children have declined;

- the larger the family, the greater the relative disadvantage in real income;

- some pensioner and beneficiary families have experienced overall decreases in real disposable income;

- the cause of these decreases is the decline in the real value of all payments to families through the social security system which mainly assists low income families;

- assistance to families through the tax system increased in real terms;

- erosion of cash payments to families, such as family allowances, has been attributed to their being exposed to greater political pressure because of their greater visibility compared with tax expenditures such as dependent spouse rebates;

- increased numbers of families with children have incomes which are below current poverty lines;

- all rates of pensions and benefits for families with children are below current poverty lines;

- current estimates of the cost of children indicate that the levels of child-related payments are inadequate in the extreme; and

- recent evidence indicates the possibility that low income families with children actually spend more income than they receive, virtually assuring destitution.

Increased Support through the Tax-Transfer System

By emphasising the interrelatedness of the taxation and social security systems, IFS hopes to encourage the greater integration of the two, especially as they affect the financial well-being of families with children. In much of what follows emphasis will be placed to a greater degree on changes to what are currently measures operating under the rubric of social security. Nevertheless, the point is reiterated that such measures should properly be seen in the context of taxation reform as part of recasting the overall tax-transfer system.

It is tempting to propose that no measures of assistance should

be provided in the form of tax expenditures. As tax expenditures are relatively hidden from scrutiny and represent revenues foregone, they have only recently been subjected to suggestions that they be reduced. The advantage of assistance through some tax expenditures has been that by being linked to personal levels of taxation they allow for greater tax relief at higher marginal tax rates, as money incomes increase due to wage movements. Cash payments for children on the other hand, have only been increased by political decision, family allowances only once, effectively, since their inception.

Assistance to other groups such as business and industry, superannuation funds, etc. is commonly provided via tax expenditures thereby avoiding the intense public scrutiny experienced by cash outlays, and are open-ended with little estimate being made of their real cost. These advantages have led to some groups proposing that all assistance to families should be channelled through the current tax system in the form of rebates and/or credits. Alternatively a purer approach might be to insist that all assistance to business, industry and families be cashed out so as to be equally assessed as to priorities, although this would involve vastly greater administration as increased tax receipts would then be offset by cash subsidies back to firms and individuals. Certainly it is worth moving to the situation when all such government support is at least accurately documented and set within the context of specific targets. This being so, some support for families may best be retained within the tax system via credits and rebates, provided such assistance is carefully integrated with those cash payments continued as part of the tax-transfer system.

Proposals to Achieve Increased Family Support

The following sections of the submission will describe approaches regarded by the IFS as desirable directions in which to move in order to support families in their function of raising children

and in lifting the levels of income received by many disadvantaged families. The basic proposition is that such families will require far greater support within the tax-transfer system than they now receive and that such support should be delivered as efficiently as possible.

The Institute is of the view that ideally, far-reaching changes should be made that simplify the system and provide all families with a guaranteed income assessed only against their demonstrable need for such support. By integrating fully the income support and taxation systems, the poverty traps and disincentives to work generated by high effective marginal tax rates would be minimised. As noted in an earlier IFS publication, however, resistance to such sweeping reform is endemic in Australian political structures (Saunders, 1982) and the road to reform has been paved with myriad small stepping stones. The accumulation of these incremental changes has certainly improved the tax-transfer system somewhat since the calls for fundamental change began over a decade ago. However many problems still bedevil the system, not the least those described above which have seen assistance to families with children become so badly eroded.

The following proposals, then, move incrementally from one level of reform to another, culminating in yet another challenge for Australian policy-makers to fashion a bold structure that will more adequately embody the equity, efficiency and simplicity objectives constantly called for yet only ever falteringly achieved. The IFS recognises the many pitfalls that await the serious tackling of such a challenge and therefore has settled for second, third and even fourth best in proposing some directions for change that it regards as fundamentally essential as the very least that should be extracted from the current processes of reform. Unfortunately resource constraints have prevented much of this work being thoroughly assessed as regards unforeseen outcomes and levels of costing. Nevertheless, with this caveat, they are submitted as suggestions that at least

incorporate those principles which would see Australia's families raising children given the levels of support they require and deserve.

Indexation of Child-related Payments

At the very least it is essential that payments to families related to the presence of dependent children be indexed. As noted before, any reductions in the real value of family allowances, additional pension or benefit for children or mother's/guardian's allowance amount to an increase in the tax burden of the recipient families. As shown in Table 1 the following reductions have occurred in real terms due to erosion through inflation over the period 1976-77 to 1984-85:

- family allowance (one child) - 22.4%
- additional pension or benefit for children - 7.1%
- mother's/guardian's allowance - 18.2%

As average weekly earnings have increased by over 12 per cent in real terms over the same period the net effect has been to widen the gap between families with and without children, especially disadvantaging many low income families.

Since 1976-77 family allowances have effectively only been increased once and payments to pensioner and beneficiary families, while increased in the last two budgets have still not maintained their value. This is because political and budgetary considerations determine their adjustment and not a commitment to maintaining the real levels of incomes of these families. Indexation, as with other social security payments such as the base rates of pensions and benefits, is the only defensible option.

A Revised System of Family Allowances

The current system of family allowances pays different rates according to the number of children in a family (see p. 7), thus recognising the higher unit costs associated with large families. It does not take into account that children cost more the older they get as recent research has shown (Table 4). The Institute of Family Studies proposes that a more realistic basis for payment of family allowances would be age-related. The rates of payment should be both lifted to restore their real value and structured so that large families now receiving a certain level of benefit would not be worse off. Appropriate age categories might be delineated at the age of going to secondary school, say after 12 years of age, and at the legal school leaving age, say after 15 years of age. Three rates of payment would then apply, for ages 0-12, 13-15, and 16-24 if dependent students. The payment could be made to the parent most responsible for care up to age 15 and then either all to the child or progressively, so that by age 18 it was all paid to the child. The payment would not be taxed nor means-tested.

Such changes would restore a large measure of horizontal equity to the tax-transfer system as it affects families with children. It would also go much further toward meeting the actual costs incurred as children grow older. In addition, it would provide some incentive for students to remain in school after the minimum leaving age, an objective now regarded as important both for the individual well-being of young people as they must compete on a more crowded labour market, and for the nation as the development of a more highly educated labour force is important for future economic growth. The rates of pay that would be necessary to ensure that most large families are no worse off, and that approximately reflect the cost ratio of teenage to younger children would be as follows:

Age of child	$ per week
0-12	8.30
13-15	14.00
16-24	18.00

If such rates were paid for the number of children in each age category in 1983-84, the extra cost would be about $770 million.

Not all of this payment need be in the form of cash payments as taxpayer recipients could be provided with a tax credit. Those working part-time with incomes close to tax thresholds could receive a reduction in tax plus a part payment in cash. If 40 per cent of recipient parents were in the workforce the cash outlays associated with the scheme would be reduced proportionately by incorporating tax credits.

Finally, increases in family allowances will assist in ensuring that the recipients of the payments, usually the mothers, receive a fairer share of the distribution of household incomes. An age-related increased family allowance could subsume the child-related component of the tax expenditures made to taxpayers with a dependent spouse and children.

The Need for a Supplementary Payment

While greater support for families with children as compared with those without can be achieved by the above approach, extra measures are still necessary to bring many families out of poverty and to thereby improve the redistribution of incomes through the tax-transfer system. Currently pensioners, beneficiaries and other low income families may receive a supplementary payment to compensate for the presence of children, subject to an income test. Modifications to the current system could include an age-related component to the supplementary payment, whereas currently additional pension or benefit is paid at a flat rate of $14 per week, and a uniform rate of withdrawal

could be applied, whereas currently the additional payment is withdrawn at the rate applying to the category of basic benefit and is 100 per cent for unemployed families. The following rates of supplementary payment could be applied:

Age	$ per week
0-12	18
13-15	22
16-24	27

Such rates of payment would lift many families out of poverty, especially those with older children whose costs are highest. For example, a beneficiary couple with two junior high school children would move from being nearly twenty dollars below the poverty line to being nearly twelve dollars above it. However, even with such changes some families, while being better off, would still be below the poverty line if they had three children under 12, for example. One-parent families on benefits have incomes so low that further assistance would be needed to bring them above the poverty lines.

Another objective that could be achieved at these levels of assistance would be to encourage low income families to keep their older children at school. The combined extra family allowance and supplementary payment for over 15 year olds would equal $45, the current rate of junior unemployment benefit. The income support available for over 15 would then provide no incentive for them to become unemployed. As such this scheme would subsume the current Secondary Assistance Scheme (SAS) paid to low income families when their children are in years 11 and 12 at school, with the additional benefit that such education-related support would be age-related and would not discriminate against those who are currently ineligible at age 19 or if aged 16 to 18 but not in the appropriate years at school.

Inadequate Income Support and Poverty Traps

As indicated above, current levels of income support are so low for some families that not even substantial increases in child-related benefits can raise their incomes to acceptable levels. Families may experience very low levels of income for various reasons - unemployment of one or both parents, sickness or incapacity to work, low levels of earnings, sole parenthood, age and so on. The current social security system allocates families to categories such as unemployed, supporting parent, aged, sick, special and so on. It then applies different tests of eligibility and treats extra earnings differently. If a family is receiving assistance through the taxation system such as the dependent spouse, sole parent or pensioner rebate, there is often an overlap between the withdrawal rates of payments and the taper on such rebates, or the standard rate of income tax. Such interaction of the two systems causes high effective marginal tax rates.

High effective marginal tax rates faced by pensioners and beneficiaries over a wide range of private income exceed the highest personal income tax rate of 60 per cent. If the costs of working are taken into account, such as travel and child care costs, additional earnings make a pensioner or beneficiary little better off, and in some instances worse off, and thereby placing them in so-called poverty traps. If an integrated system can be designed that reduces the number of benefit types and thereby the number of withdrawals of payments according to increased private income, the effective marginal tax rates can be reduced.

The following suggestions incorporate several of the necessary considerations that would need to be taken into account if an integrated system of family support was to be designed. It does not pretend to have addressed all the difficult issues involved adequately nor to have been so thoroughly analysed as to identify all the unintended or unforeseen consequences that might flow from a move to such a system. Rather it is an attempt to

encourage policy designers and decision-makers to reach for bold approaches and cut through the debilitating cautiousness that surrounds tax-transfer reform. More resources are required than IFS possesses to completely test such schemes and develop them to a more refined state. Those resources do exist within government and they largely relate to information. If the data possessed by the Taxation Department and by Social Security were combined with clear policy objectives to guide them, the bugs in systems such as the following would most probably be quickly eradicated.

Family Income Guarantee

The aims of the proposed scheme are to:

- more adequately integrate the tax and social security systems;
- to provide basic income support to families and individuals in relation to their needs; and
- to especially recognise the needs of families with dependent children.

Income tax rates would be applied to individual incomes as at present but family-related rebates would be dropped. These include the dependent spouse rebate and the sole parent rebate.

The Social Security System would apply on the basis of family income defined as at present. The four essential units would be:

- couples with dependent children;
- couples without dependent children;
- sole parents with dependent children; and

. individuals.

Net (after tax) income (FI) would be obtained for all members of the unit combined.

An adjusted family income (AFI) would then be derived reflecting relative needs of families. This would be done on the basis of an equivalence scale (ES) for each family type to be derived from the Household Expenditure Survey.

$$AFI = \frac{FI}{ES}$$

The equivalence scale would be set at 1.00 for an individual and scaled upwards for the addition of adults and children.

The scale would incorporate varying allowances for children depending upon their age to reflect the fact that older children cost more.

Once all families are placed on a common scale (AFI), this scale can be used to determine their eligibility for social security payments.

Equivalence scales would be revised on the basis of five yearly or more regular Household Expenditure Surveys.

Social security payments would have three components:

. family support allowance;

. sole parent allowance; and

. children's allowance.

The latter two allowances would be universal with the sole parent allowance subsuming the present sole parent rebate and the

mother's/guardian's allowance. The children's allowance would be paid at the restructured rates of family allowances described earlier in the submission.

These can be seen as horizontal equity measures as part of the tax system.

The family support allowance would incorporate all present social security benefits and pensions. It would be income-tested on the basis of AFI and work-tested in the case of individuals and one (either one) of the parties in a couple family. As at present, sole parents would not be work-tested. The rate should be set so as to improve the current level of support available to one-parent families and low income taxpayers who would be disadvantaged by the loss of the dependent spouse rebate.

Payments under the family support allowance would incorporate standard rates for adults and rates for children dependent upon the ages of the children, increasing rates according to the age of the child. An additional amount would be payable to the carer of a child under the age of six to compensate families for the loss of dependent spouse rebates and to allow for particular labour market barriers affecting parents of under school age children.

Adult payments would be made to each eligible adult and child payments would be made to the principal carer.

Where earnings overlap with the income support system, tax credits should be used to reduce cash payouts.

As the family support allowance would be the only payment tapered away as private income rose, the effect on marginal tax rates would be less than under systems with several concurrent tapers.

While there are many elements of the proposal that differ only slightly from the current system the following improvements are

made:

- there is greater recognition of horizontal equity considerations, especially with regard to the costs of older children;

- low income families are given greater support both through higher children's payments and more generous family support allowances;

- the numerous eligibility tests are reduced;

- more equitable income distribution within families is encouraged;

- incentives for children to leave school are reduced; and

- effective marginal tax rates and subsequent poverty traps are reduced.

The obvious disadvantage is that greater costs could be involved. The costing would depend upon rates of payment, setting of income limits for full payment, and withdrawal rates. The use of tax credits would reduce large flows of payments and resumed taxes although only to a degree. The only families currently receiving assistance through the tax-transfer system to be knowingly disadvantaged by this scheme would be higher income families without children and some with all children over age six who would lose the benefit of the dependent spouse rebate. Consequently there is only a partial element of redistribution within the revenue structure of the current system. Ultimately the decision has to be made whether the Australian community is prepared to back families raising children and properly assist low income families in ways that do not lock people into dependance on government benefits. Only then will the resources necessary to achieve these aims be available.

The Need for Services

It should not be forgotten that tax revenue is collected in order to provide services as well as income support in the form of tax-transfer. So discussion of tax reform must keep in mind the balance between support in the form of cash or tax benefits and support via service provision.

Families require a broad range of services to enable them to cope with the demands of meeting their responsibilities. Children's services are in an undeveloped state in Australia, as are programs to enable women to retrain for today's labour force, and domiciliary services to support families in the care of the elderly.

In the current climate of budgetary restraint and tax reform, we wish to stress the notion of a public/private partnership for family support in relation to services as well as tax-transfers. Access to an all-day child care centre, or even a before and after school care service, may be of greater assistance to many families than small reduction in tax or a small cash payment. People today do not regard schools or hospitals as a form of 'welfare', yet they will complain about the cost of other government services such as public child care centres, home help or financial counselling. These are no different in kind from schools, hospitals or public transport. The point to be made is that families need support both in the tax-transfer system and through the provision of community services. While it is inappropriate in this context of discussing reform of the taxation system to canvass fully the case for service provision, it is important that notice be taken of this need when taxation policies are being considered. Again, we stress, the goal should be adequate support for family stability and a wise investment in the future of our children.

Proposed Changes to Tax Measures

The Institute is not in a position to assess the impact on families of all the proposed changes to the tax structure. Consequently the relative merits of the various means of raising tax revenues will remain to be more expertly discussed by other commentators. On the available evidence, however, the IFS is concerned about the possibility of greater reliance on broadly-based consumption taxes.

The impact of indirect taxes on families

A marked shift in the tax mix to indirect taxation, particularly broadly-based consumption taxes, will have a detrimental effect on all families with children, particularly low income families, at least according to the available evidence, much of which leaves room for improvement.

Data from the 1975-76 Household Expenditure Survey (Table 5) shows that low income families spend a greater proportion of their income than higher income families, and that, at any income level, the more children in a family, the greater is expenditure as a proportion of disposable income (Warren, 1983:199; Cox and Foster, 1985; Harding and Whiteford, 1985).

- INSERT TABLE 5 HERE -

1975-76 Survey data also indicates that low income groups and all families with children spend a significantly larger proportion of their disposable incomes on food than higher income groups and families without children (Table 6).

- INSERT TABLE 6 HERE -

Preliminary data from the 1984 Household Expenditure Survey supports these findings (Harding and Whiteford, 1985:22-24).

Data from the 1975-76 Household Expenditure Survey also suggests that lower income groups and families with children spend a greater proportion of their disposable incomes on clothing than higher income groups and families without children. Recent studies have shown that a tax on children's clothing and footwear is highly regressive; a tax on adult clothing only mildly regressive (Kakwani, 1983).

These findings indicate that low income families with children could be particularly disadvantaged by a broad-based consumption tax which extended indirect taxes to food and clothing.

It has been proposed that personal income tax cuts will be introduced to offset price rises due to the introduction of indirect taxes. However, some low income people do not earn sufficient income to pay tax or pay very little tax, so would not benefit from tax cuts. Similarly, large families would not be compensated by tax cuts since there are no measures in the present taxation system which relate tax relief to the number of children in a family.

It has been argued that 'full indexation of social security benefits, including family allowances, takes care of most of the problem (of compensating low income groups and families with children)' (Groenewegen, 1984:120-1). None of the children's payments in the social security system is indexed at present. It has also been suggested that an 'ad hoc' increase in the children's allowance, family income supplement and family allowances, would compensate families for the introduction of indirect taxes (Cox and Foster, 1985:24). However, it has also been stressed that all children's payments must be indexed to retain their real value, not only against the price rises which occur as a direct effect of the introduction of a broadly-based indirect tax, but also because of longer-term effects, which have

occurred in similar circumstances in other countries, such as wage increases (Harding and Whiteford, 1985:38, Sandford, 1985:15). Unless children's payments are indexed, the burden of taxation will be shifted further towards families with children with the introduction of a broadly-based consumption tax.

At the same time, doubts have been expressed as to the adequacy of the CPI as a compensation measure (Cox and Foster, 1985:19; Harding and Whiteford, 1985:33). Because the expenditure patterns represented in the CPI do not reflect those of low income groups and families with children, such groups may be disadvantaged if there is a rise in the price of items, such as food, which account for a large proportion of their expenditure. For instance, if the price of food rises significantly more than the price of other commodities, families whose expenditure on food is more than 21.2 per cent of their total expenditure, will not be adequately compensated for such price rises, whereas families who spend significantly less than 21.2 per cent of their total expenditure on food may be over-compensated (Table 7).

- INSERT TABLE 7 HERE -

Some concerns have also been expressed about the time lag between price rises and increases in social security payments. It has been estimated that there could be a time lag of up to ten months between price increase and subsequent social security payment increases (Cox and Foster, 1985:16, Harding and Whiteford, 1985:34) causing further stresses for low income families who are already facing difficulties in trying to keep their expenditure within income limits.

A major difficulty in designing compensation measures for the effects of indirect taxes is that such measures involve huge money outlays and yet provide no real change in the disposable incomes of low income groups and families with children (Ingles

and others, 1982:33-34).

Consequently it seems likely, in light of commitments given to not increase government outlays and in the current climate of taxpayer resistance, that even raising the level of expenditure necessary to merely compensate low income families for a move to greater indirect taxation will be extremely difficult for a government to achieve.

If the political feasibility of simply maintaining the current, albeit inequitable, distribution of income in Australia is so low, it seems that the chances of restoring the value of support for children existing a decade ago or of ultimately improving the plight of the more than 750 000 children living in families below the poverty line will be small indeed if the tax mix shifts substantially toward broad-based indirect taxation. At the very least, any such shift to indirect tax must involve compensatory measures such as those described in this submission.

Conclusion

Apart from the evidence that indirect taxes will disadvantage families with children, IPS is not able to comment on the likely impact of other tax measures. There does seem to be strength in the argument that whatever can be done to broaden the tax base by addressing the many ways of converting income into capital or perks should be done in order to increase the pool of revenue available for redistribution. Income taxes might then still be lowered without revenue being lost.

Whatever the final shape of a reformed tax structure the Institute reaffirms its basic tenets:

. that assistance to families with children should be improved, not further reduced; and

- to improve the efficiency of the tax-transfer system greater integration and coordination of the social security and taxation systems is essential.

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Table 1: Changes in the real value of payments through the social security system, 1976-77 to 1984-85

Payments per week	Actual level 1976-77 $	Equivalent value 1984-85 $	Actual level 1984-85 $	Real change %
Family allowance:				
1 child	3.50	6.78	5.26	-22.4
4 children	20.50	39.71	30.77	-22.5
Additional pension or benefit for children	7.50	14.53	13.5	- 7.1
Mother's/guardian's allowance	6.00	11.62	9.5	-18.24
AWE	179.00	346.76	389.50	+12.3
CPI (1980/81 = 100%)	70.1		135.8	

Source: IFS AFIT project

Table 2: Changes in the real value of family-related tax rebates, 1976-77 to 1984-85

Rebate (per annum)	Actual level 1976-77 $	Equivalent value 1984-85 $	Actual level 1984-85 $	Real change %
Dependent Spouse Rebate:				
Without children	500	969	830	-14.3
With children	500	969	1030	+ 6.3
Sole Parent Rebate	350	678	780	+15.0
CPI (1980/81 = 100%)	70.1		135.8	

Source: IFS AFIT project

Table 3: Poverty lines and levels of pensions for those not in the labour force. December 1984 quarter

	Poverty line $ pw	Pension or benefit + FA $ pw	Amount below the poverty line $ pw
Couple + 1 child	179.30	172.55	6.75
2 children	213.50	194.05	19.45
3 children	247.60	217.05	30.55
4 children	281.80	240.05	41.75
Single Parent + 1 child	138.30	121.15	17.15
2 children	172.50	142.65	29.85
3 children	206.60	165.65	40.95

Source: Institute of Applied Economic and Social Research, 1985

Table 4: Costs of children for low income families

Age	2	5	8	11	Teenage
$ per week (Dec. 1984)	17.81	22.84	28.00	29.72	44.25

Note: The original figures are in May 1983 dollars (Lovering, 1984:76-8). These figures have been updated to December 1984, using the CPI June quarter 1983 (127.3) and CPI December quarter 1984 (135.8). (ABS No.6401.0)

Source: Lovering, 1984

Table 5: Expenditure as a percentage of disposable income

Family type	Income under $80 a week %	Over $80 and under $140 %	$340 and over %
One adult	116.05	90.16	*
One adult and children	136.46	107.80	*
Two adults, one child	*	113.82	51.07
Two adults, three children	*	142.96	73.07

* Sample size too small to be statistically significant

Source: ABS, Household Expenditure Survey 1975-76

Table 6: Expenditure on food as a percentage of disposable income

Family type	Income under $80 a week %	$80 and under $140 %	$200 and under $260 %	Over $340 %
One parent and children	37.71	26.06	*	*
Two adults, no children	34.11	22.80	14.64	9.14
Two adults, two children	*	32.78	19.71	12.43
Two adults, three children	*	37.28	22.29	15.32

* Sample size too small to be statistically significant

Source: ABS, Household Expenditure Survey 1975-76

Table 7: Percentage of total expenditure 1975-76 HES Survey Data

	CPI weights June 1984	Two adults, no children. Income over $340 a week	Two adults, two children. Income over $80 and under $140
Food	21.2	13.8	25.6
Clothing	7.7	6.7	8.5
Housing	13.8	19.4	17.0
Household equipment	13.9	16.8	8.5
Transport	17.2	17.5	17.3
Alcohol and tobacco	9.4	5.7	6.6
Health	5.7	2.5	4.5
Recreation and education	11.1	8.3	7.0
Miscellaneous	-	9.4	5.0
	100.0	100.0	100.0

Source: ABS, Household Expenditure Survery 1975-76 and
ABS, Consumer Price Index - June Quarter 1984

The Institute of Family Studies, established under the provisions of the Family Law Act 1975, commenced operation in February 1980. The Institute functions as a statutory authority of the Australian Government, from which it derives its financial support. The founding Director is Dr Don Edgar. The Institute has a Board of Management of seven appointed members and a permanent staff of professional and support personnel. In addition, specialist assistants and consultants in appropriate fields are engaged to assist the Institute in its work when necessary.

Functions of the Institute

The functions of the Institute as defined by the Family Law Act 1975, are:

- to promote, by the conduct, encouragement and co-ordination of research and other appropriate means, the identification of, and development of understanding of, the factors affecting marital and family stability in Australia, with the object of promoting the protection of the family as the natural and fundamental group unit in society; and
- to advise and assist the Attorney-General in relation to the making of grants, out of moneys available under appropriations made by the Parliament, for purposes related to the functions of the Institute and the supervising of the employment of grants so made.

The Institute's activities centre around meeting the following needs:

- research on social and economic factors affecting the well-being of families of different types in Australian society;
- development of an objective understanding of what is happening to the family in Australia, including identification of the strengths, as well as problems, of Australian families;
- dissemination of information about families and family structures to all those whose work directly affects the lives of families;
- monitoring and reporting on the impact of government policies and administrative practices on families of various types in Australia; and
- evaluation of the effects of marriage counselling, pre-marital education and other services, including those areas of the law aimed at assisting families.

Thus the objects of the Institute are essentially practical ones, concerned primarily with learning about real situations through research on Australian families.